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DOW THEORY LETTERS

"The Market as Interpreted under the Dow Theory"

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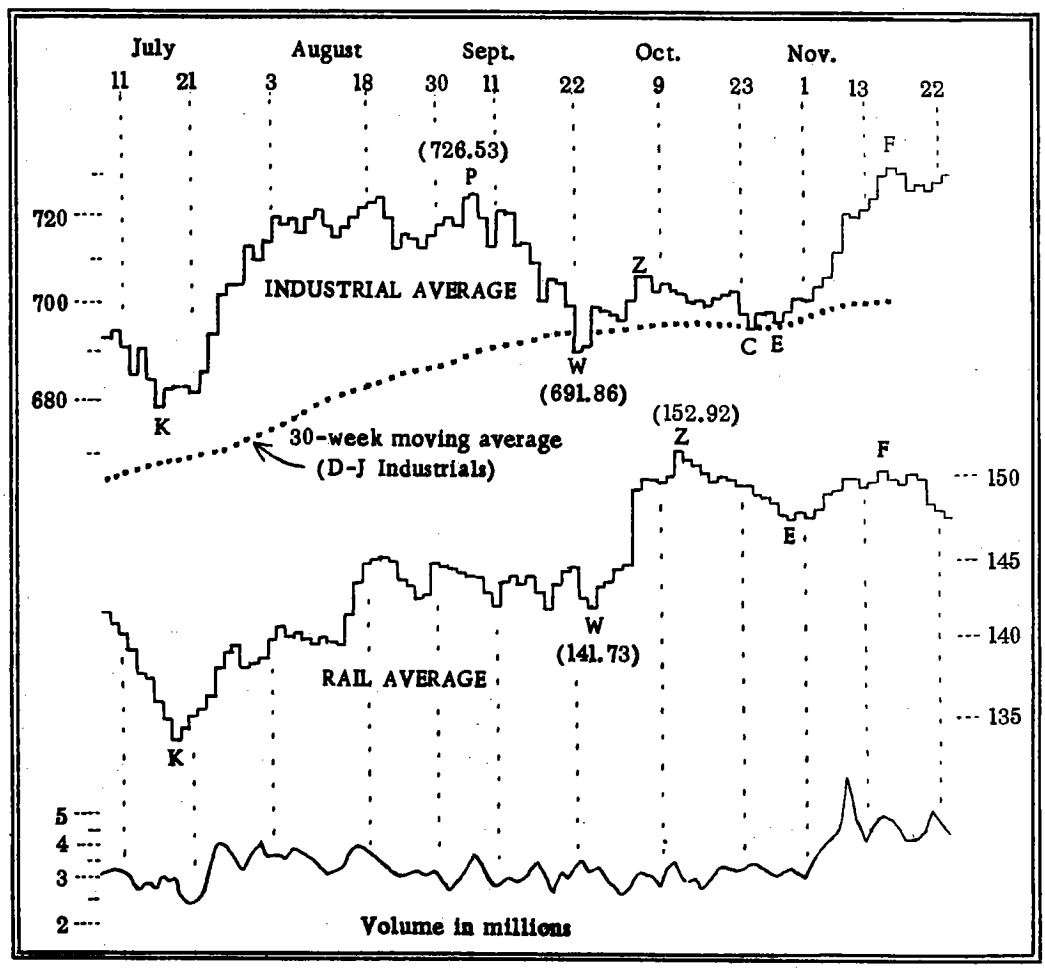
THE MARKET The Industrial rise from point C (697.24) to F (734.34) advanced the senior Average a total of 37 points to a new bull market high. Over the same period the Rail Average rose only 3.56 points (E to F), thereby failing either to establish a new high (above Z) or to confirm the Industrial advance. Technically, the current problem is: (1) will the two Averages (which are now consolidating) hold above preceding lows, then rise to new bull market highs, or (2) will the current bullish price structure break down?

Assuming a continuation of the decline, a hint as to the strength or weakness of the market may well come from the Industrial Average. The 50% or halfway level of the C-F Industrial rise is 716. If the two Averages retreat and Industrials hold above 716 as volume contracts, the situation will continue to hold bullish connotations. In the past, a refusal by the Industrial Average to retreat below the halfway point of the preceding advance (Dow's 50% Principle) has implied that the upward move has not yet been completed.

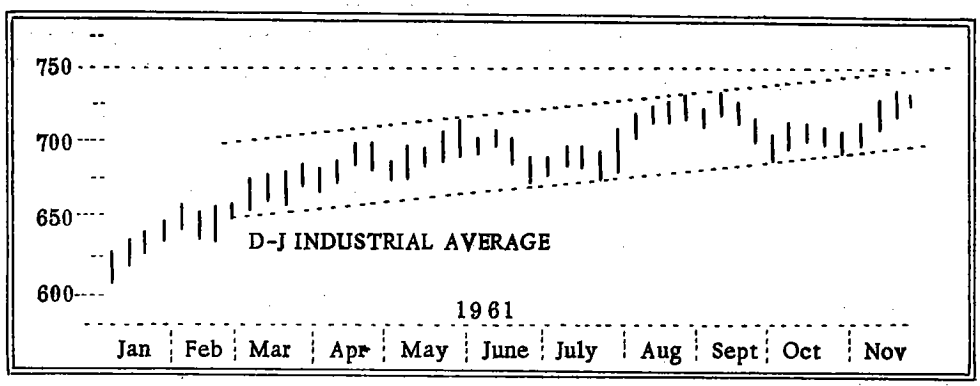
Readers should also bear in mind that under Dow Theory the last trend is conceded to remain in force until proved otherwise. The "otherwise" requires a definite reversal in both Averages. For this reason, during any forthcoming decline, as long as one or both Averages hold above the preceding lows (Industrials at C - 697.24, Rails above C - 147.63), it is reasonable to assume that the secondary trend remains bullish.

SHORT TERM Over the past three days the two Averages have diverged (moved in opposite directions), Industrials having tended higher while Rails sagged. In such situations, the market usually resolves itself in the direction of the first "in gear" movement. Thus if Industrials continue higher and Rails turn up, the odds will favor higher prices all around. Conversely, if Industrials turn down and follow the Rails (particularly as volume increases), the immediate (minor) trend will be considered down.



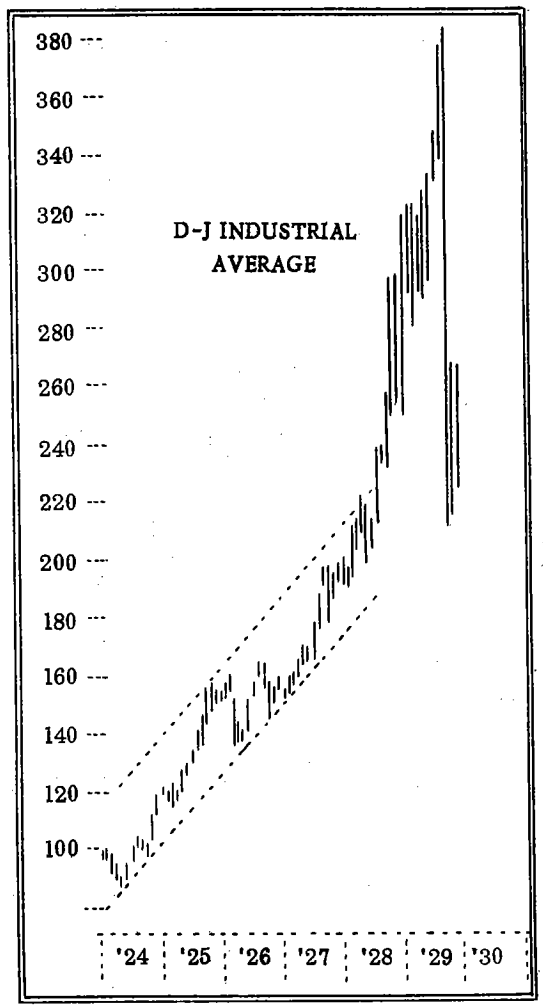
Odd-lot transactions continue on the sell side, and this provides a picture of underlying strength. The advance-decline ratio has shown no sign of weakness (so far), and this too can be considered a plus in the technical picture. The new-high index (five-day moving average) has held above 90, a third constructive indication.

"THE CHANNEL" In the book "Technical Analysis of Stock Trends", the brilliant Robert Edwards wrote: "Not only the smaller fluctuations, but frequently the great primary swings of several years' duration, appear on the charts as though their course had been plotted with a straight-edge ruler. This phenomenon is,



in truth, the most fascinating, impressive and mysterious of all that the stock charts exhibit."

Although trendlines play no part in Dow's Theory, I find it enlightening (when the price movements permit it) to analyze the market from the standpoint of recognizable chart formations. Since March of this year, the Industrial Average has been rising in a pattern which is contained within two ascending parallel lines. Such a structure (regardless of whether the parallel lines are ascending or descending) is known as a "channel". In the majority of cases, rising channels are eventually broken in a downward direction. By the same token, declining channels are usually broken in an upward direction. Occasionally, however, a rising channel will be broken upwards. When this occurs, the rallying force can be explosive.



Few people realize, for instance, that the Industrial price pattern from 1924 to 1928 was contained within a single rising channel. In early 1929, the rising channel was penetrated upwards, and the resultant force can best be seen on the accompanying monthly chart.

In view of the strong current technical situation, one cannot help but speculate as to what might happen if the present ascending channel were to be broken in an upward direction. The accompanying 1961 chart shows that a rise over 750 would take the Industrial Average above the upper limits of the 9-month channel now in existence. If this occurs, it could well signal a great speculative rise during which the bull market might finally and irrevocably "blow its top".

ODD-LOTS The advance since the July, 1961 lows has been extremely selective. The best performers on the rise have been investment-grade stocks, many of them priced beyond the reach of the general public. In fact, so marked has been the trend towards "blue-chip" buying that Newsweek Magazine, in its recent market column, referred to the situation as "The Rich Man's Bull Market".

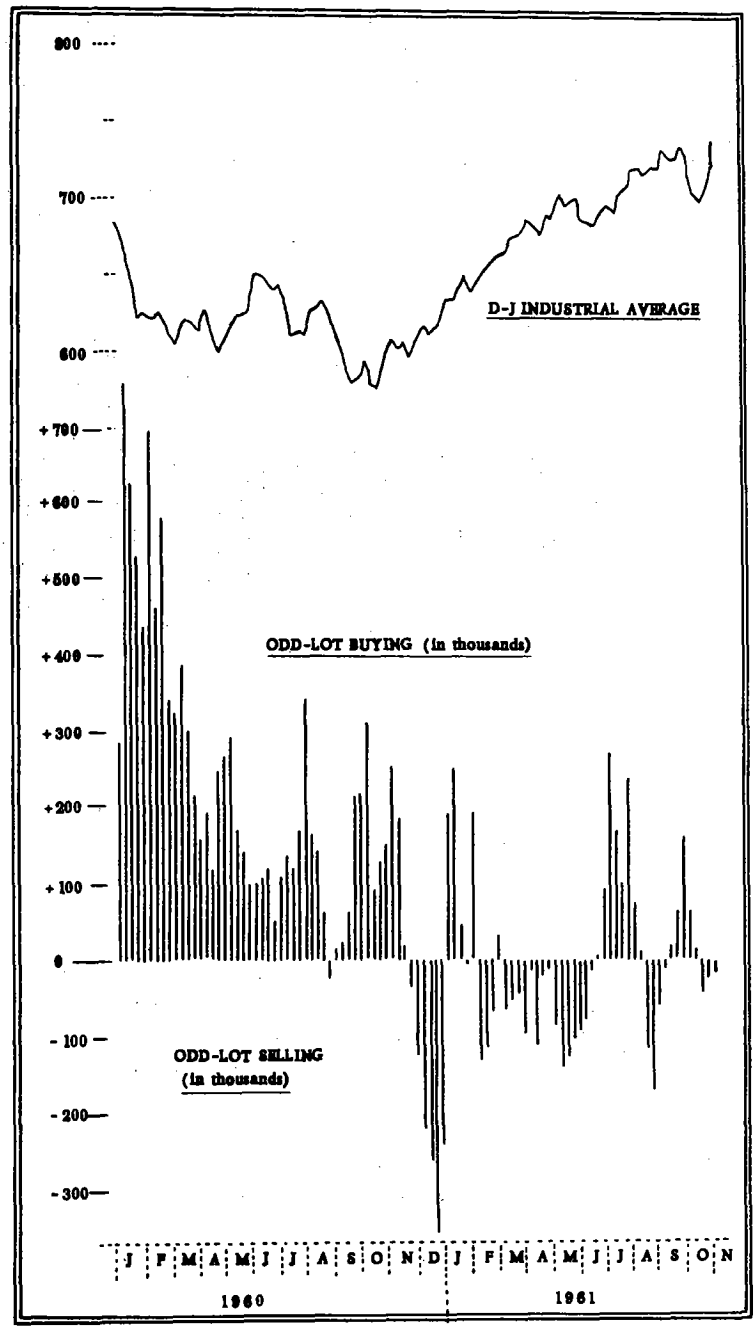
As a rule, stocks must be accumulated (often for many weeks or months) before an advance can be set off. Intelligent accumulation is executed by "informed money", and most often under the guise of a dull market or a market which has been buffeted by unfavorable news (the worse the market psychology, the better the conditions for the accumulators). Following the period of informed accumulation, conditions (sooner or later) will change, and those conditions are usually such that the accumulated stock gradually becomes attractive to the less sophisticated elements in the market -- i.e., the public. In the majority of cases, the "changing conditions" result from (1) an improving economy and market climate, (2) improving circumstances pertaining to an individual issue or its group.

Studies over the years suggest that the action of the odd-lot (under 100-share) buyer is representative of the general public. In order to understand the meaning of odd-lot activity, however, a few basic principles must be grasped: (1) The public normally possesses a bullish (we might call it a constructive) bias -- the public normally buys more stocks than it sells. Ten shares bought for every nine shares sold might be termed a "normal" odd-lot relationship. (2) Odd-lotters ordinarily increase their buying in a declining market ("lower prices are bargains"); odd-lotters normally decrease their buying in a rising market ("higher prices represent a golden selling opportunity"). It is the deviation from normal odd-lot behavior which is significant. (3) Despite the wide-spread misconception, the odd-lot public will eventually get on "the right side" of every major market swing. But the public is apt to be most wrong at important market turns.

The accompanying chart shows the weekly balances of odd-lot purchases over sales (or sales over purchases) since Janurary, 1960. Since the D-J Industrial Average is the most widely-followed market indicator, the public is most apt to react to the movements of that Average. For this reason, I have plotted odd-lot statistics together with the D-J Industrial Average.

The extremely heavy odd-lot buying of early 1960 was a reaction to the settlement of the steel strike. Subsequent events underscored the error of the public's initial reaction, and the Industrial Average sagged badly throughout most of the year 1960. During the third quarter of 1960 the odd-lotters finally got "with" the situation (they sold), but the odd-lotters happened to pick the bottom of the entire move to do their selling in. Obviously, the odd-lot public was wrong again (at the turn).

A short period of odd-lot buying appeared in early 1961, followed by another area of odd-lot selling. Throughout the 1961 period the market moved conistently higher. In September, 1961, another short period (five weeks) of odd-lot buying appeared, but not that this was the least enthusiastic of the three odd-lot buying areas since the October, 1960 lows.



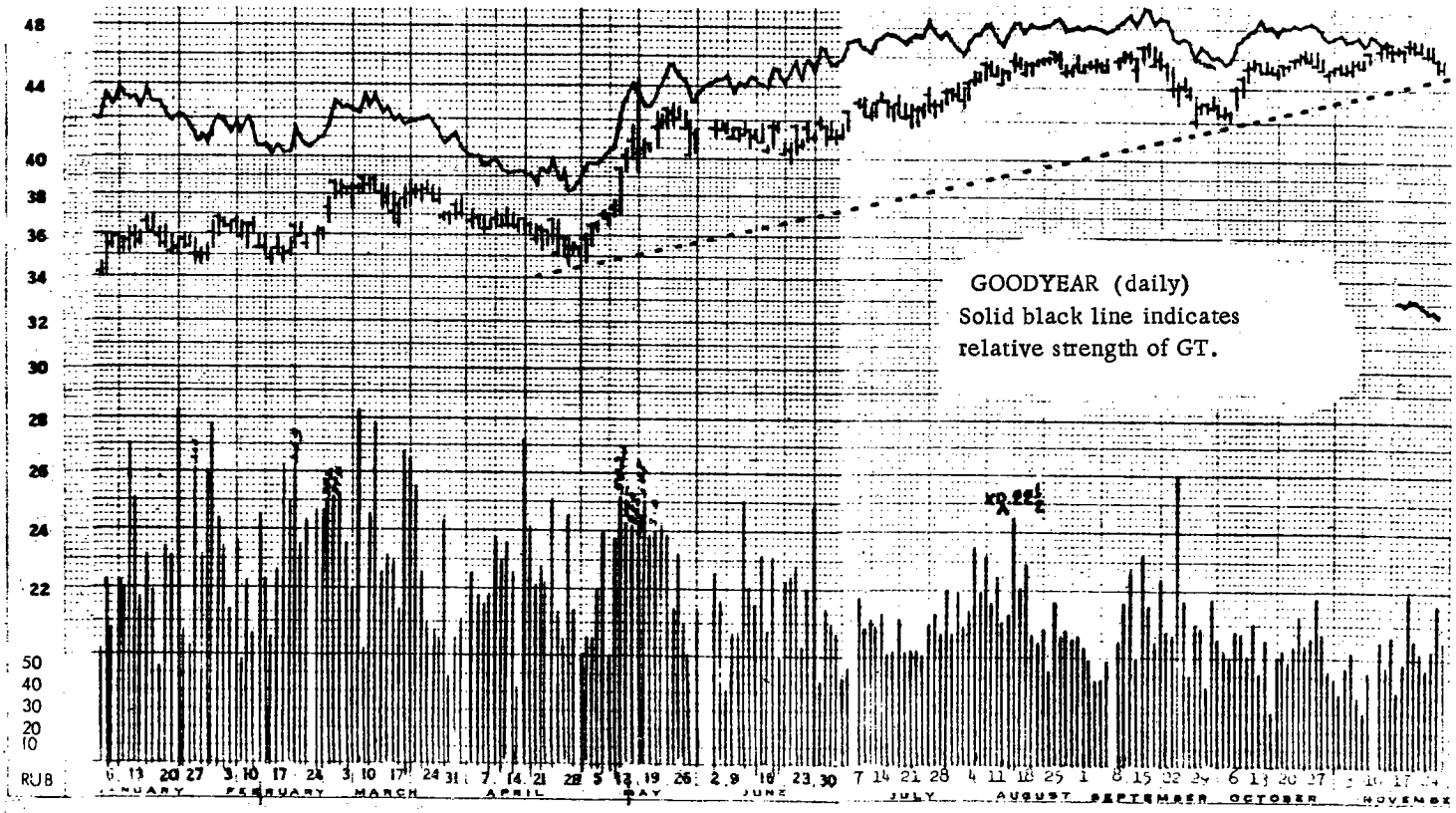
Most recently, as the market climbed to historic highs, the odd-lotters again sold more than they bought. The question now is -- will the public eventually repeat their old habit--namely, switch to the buy-side of an advancing market?

History suggests that sooner or later the public will again get on the right side of the market. So far, this has not occurred. All of which implies that the market remains technically strong. Since the entire rise has taken place in the face of a bearish public, it is reasonable to assume that it has been the stronger (informed) element in the market that has been pushing prices higher.

The final question is -- what happens when the public does turn bullish? A switch to odd-lot buying (particularly heavy buying) will probably signal a broadening out of the present "rich man's market" into a speculative "public market". For the present, however, we may conclude that the market remains technically strong. When consistent odd-lot buying finally appears (in response to higher prices), the technical position of the market will begin to weaken. Moreover, when odd-lot buying roughly comparable to early 1960 occurs, the danger signals will be flying, and the signs will point to the imminence of a major bull market top.

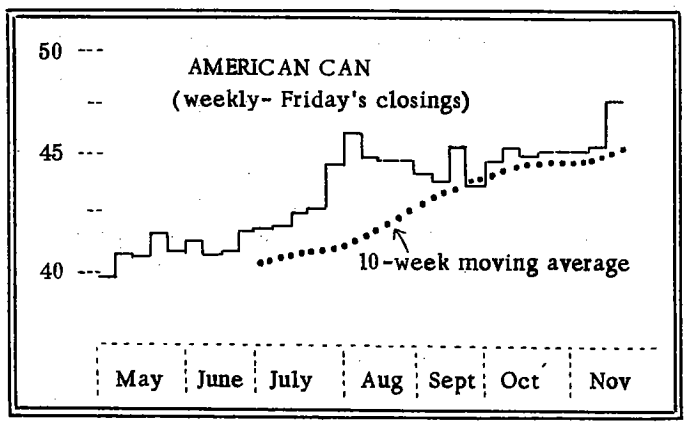
NOTES ON THE CANADIAN MARKET My friend Iain Fraser of 159 Bay Street, Toronto, shows that the Canadian Exchange continues strong. Of 16 basic Industries, 13 are now in bullish trends and only 3 are bearish. Of 100 key stocks which Fraser follows carefully, 78% are now in a bullish trend. His most recent Letter point to increasing strength in the metals and Western oil stocks. In fact Western oils, having dropped (on Average price) from 194 in 1957 to a low of 78 in August of 1960, are now showing definite signs of a major reversal. This would suggest coming strength in such Canadian oil issues as Imperial Oil, Home Oil "A", Pacific Petroleum and Central Del Rio.

STOCKS Goodyear (page 4) was originally recommended (Letter 144) at around 40. Letter 153 suggested taking part profits near what proved to be the high of the move (47). The daily chart shows that since May of this year GT has fluctuated within a narrow range. The stock touched a low of 42 in September, and that low has not since been approached. A second low of 44 1/8 was recorded in October, and last week GT dipped within a point of that figure. The long-term trendline (dotted line) on GT currently comes about the 44 level. There would now appear to be an interesting trading "play" in GT. Purchases may



be made in this area in the hopes that the stock will hold above the long-term trendline, then rise above the year's high at 47 3/8.

A drop below 44 (the trendline) and a further drop below the September low (42) would be needed in order to put GT in the bearish catagory. As of this writing, GT is acting reasonably well; it is one of the important issues in the relatively strong rubber group (most of the other leading rubbers have recently risen to 1961 highs).



The container group is one of the strongest on the "Board". American Can, perhaps forgotten in a market that looks for spectacular rises, has been acting extremely well. Its current 10-week moving average (with 3-week delay) is 45 1/8, and the stock has recently risen to a high for the year. I list AC as a buy at the market (or on any dip).

Lorrilard and Burlington, recently recommended, have broken to new high ground and should be held. Chadbourn Gotham, recommended in the last Letter, rose to a new high this morning of above 7 1/2. For those who are speculatively inclined, CGI has warrants (over the counter) which are convertible at a price of 9 until 1965.

Chart of Goodyear courtesy of Trader Research, P. O. Box 6185, Lambert Airport, Mo.

Written Monday November 26, 10 A.M.